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In the Supreme Court of the United States

OCTOBER TERM, 1933

No. 225

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

OTTO H. FALK, ET AL., EXECUTORS OF THE ESTATE OF CHARLES F. PFISTER, DECEASED

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 97–102) is reported in 24 B.T.A. 299. The opinion of the Circuit Court of Appeals (R. 117–119) is reported in 64 F. (2d) 171.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 6, 1933. (R. 120.)[1] A petition for a rehearing was denied May 1, 1933. (R. 120–121.) The petition for a writ of certiorari was filed July 1, 1933, and was granted October 9, 1933 (R. 122). The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether beneficiaries of a trust receiving distributions of income are entitled to deductions for depletion of the mineral property constituting a part of the corpus of the trust.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra*, pp. 26–34.

STATEMENT

The judgment below reversed the orders of the Board of Tax Appeals in seven cases which were consolidated for hearing. The facts are the same in all

[1] Seven petitions to review determinations of the Commissioner of Internal Revenue were consolidated for hearing before the Board of Tax Appeals. A separate order was entered by the Board in each case. (R. 102–104.) One petition for review was filed in the Circuit Court of Appeals including all of the cases (R. 104–107), and a single judgment was entered reversing each of the decisions of the Board of Tax Appeals. Since the cases were all heard on the same record in the Circuit Court of Appeals, and a single judgment was entered by that court, a single petition was filed here under the title by which the case was designated in the court below.

the cases and were stipulated (R. 79–97) and found by the Board (R. 98–101) in substance as follows:

On or about November 29, 1916, the Pfister Land Company, a Wisconsin corporation, conveyed certain property to Charles F. Pfister, Jesse Hoyt Smith and John W. Mariner, as trustees, to hold in trust during the lives of Smith and Mariner and for twenty-one years thereafter. (R. 82–96, 98.) The trustees were given full powers of management with authority to sell, lease, mortgage or otherwise dispose of the trust property. After provision for the payment of taxes and necessary expenses incident to administration, including compensation for the trustees, the trust deed provided (R. 90):

> Except as above authorized to be expended, paid out or retained, all proceeds which shall come to the hands of the Trustees from said property or from any use which may be made thereof, or from any source whatsoever hereunder as received by the Trustees shall belong to and be the property of the beneficiaries hereunder to be distributed and paid over to them in proportion to and in accordance with their respective interests as shown herein, or as the same shall from time to time appear as hereinafter provided.

The beneficiaries named in the trust deed and their respective interests were as follows (R. 90):

Jesse Hoyt Smith	One Quarter
Lucinda W. Mariner	One Eighth
John W. Mariner	One Eighth
Charles F. Pfister	One Eighth
Louise F. Vogel	One Eighth
Executors of and Trustees under the Last Will and Testament of Jesse Hoyt, deceased	One Quarter

Before the years here involved Ida Lane Smith had succeeded to the interest of Jessie Hoyt Smith, the Elmwood Company had succeeded to the interest of Louise F. Vogel, and John W. Mariner, already owner of a one eighth interest, had succeeded to the interest of Lucinda W. Mariner. (R. 100–101.)

Upon certain conditions persons holding 51 percent of the beneficial interest in the trust could terminate it prior to the expiration of its term. Upon the expiration of the trust by lapse of time or otherwise, the trustees were directed to reconvey any property remaining in the trust to the settlor, the Pfister Land Company. (R. 92–93, 99.)

Part of the property conveyed to the trustees was known as the "Bristol Mine" and was subject to a mining lease for a term of about fourteen years. The royalty rate reserved in this lease was nineteen cents per ton. (R. 99.) The trustees have distributed the entire royalties received from the mine among the beneficiaries, according to their respective interests, except that they have paid or reserved costs of administration and prior charges. They have not reserved any portion of the royalties as a depletion reserve. (R. 80, 100.)

For the calendar years 1922 to 1926, inclusive, the fiduciary returns made by the trustees showed depletion deductions based upon a depletion rate of 13.255

cents per ton.[2] The Commissioner disallowed this deduction and increased the distributive share of each beneficiary by a proportionate amount of the depletion deduction. Pursuant to this action he determined deficiencies against Charles F. Pfister for the years 1922 and 1923 (R. 6, 16), against Ida Lane Smith for the years 1923, 1924, 1925, and 1926 (R. 29, 64); a deficiency against J. W. Mariner for the year 1923 (R. 41) and deficiencies against the Elmwood Company for 1923 and 1926 (R. 53, 76).

The Board of Tax Appeals sustained the deficiencies determined by the Commissioner. (R. 102–104.) The Circuit Court of Appeals held that the respondents were entitled to deductions for depletion and reversed the decision of the Board. (R. 120.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the respondents were entitled to a deduction for depletion of a mine constituting the corpus of a trust from which they received distributions of income.

2. In failing to hold that there is no statutory authority in the Revenue Acts of 1921, 1924 and 1926 for the allowance of a deduction for depletion to beneficiaries of a trust who receive distributions of trust income but have no remainder interest in the corpus of the trust.

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[2] The amount of depletion to which the respondents are entitled, if such a deduction is allowable, has been stipulated and is not in dispute. (R. 80, 99–100.)

SUMMARY OF ARGUMENT

I

The entire amount of royalty payments was income in the constitutional sense and the taxpayer is not entitled to a deduction unless the statute specifically authorized it. It has been established by many decisions of this Court that the entire proceeds from the working of a mine are income and may be subjected to taxation without any allowance on account of depletion. *Stanton* v. *Baltic Mining Co.*, 240 U.S. 103; *Burnet* v. *Harmel*, 287 U.S. 103, 107–108. The taxpayer is therefore claiming a deduction from an item which is admittedly subject to tax as gross income. We submit that there is no provision in the Revenue Acts of 1921, 1924 or 1926 which allows a deduction to a taxpayer on account of depletion of a mine leased by a trust of which he is a beneficiary.

II

Section 219 of the Revenue Acts of 1921, 1924 and 1926, relating to the taxability of trusts, contains no express provision that a beneficiary of a trust shall be allowed a deduction on account of depletion of trust property. Moreover, the section expressly provides that the beneficiary shall include in computing his tax that portion of the income of the trust which is distributable to him. The statute makes the beneficiary taxable on his distributive share, and on all of his distributive share. If Congress had intended that this share should be reduced on account of depletion sustained by the trust, it seems reasonable to suppose it would have said so.

In *Anderson* v. *Wilson*, 289 U.S. 20, this Court held that a trust was a separate entity under Section 219 of the Revenue Act of 1921 and that there was no provision in Section 214 of that Act under which an individual receiving income from a trust might be allowed a deduction for a loss resulting from a sale of trust property. The deduction for depletion is authorized by the same section of the statute as that involved in *Anderson* v. *Wilson*. We submit that the same principles that prevented the allowance of a deduction for a capital loss to the beneficiary in the *Wilson* case prohibited the allowance for depletion in this case.

It has been held in many cases that one taxpayer may not take a deduction properly allowable to another even though the "economic pinch" is ultimately felt by the former. Here, the mining property is owned by the trust and not by the beneficiaries, and the trust alone is entitled to the deduction. So far as beneficiaries of trusts are concerned, there is no reason for distinguishing between depletion and depreciation; and it has been held in many cases that beneficiaries of trusts may not take a deduction on account of depreciation of the trust property nor on account of a so-called "operating loss" of the trust.

The cases of *Palmer* v. *Bender*, 287 U.S. 551, and *Lynch* v. *Alworth-Stephens Co.*, 267 U.S. 364, recognizing that sublessors and lessees may be entitled to depletion, do not justify such an allowance to beneficiaries of trusts. Lessees have an investment in the mining property and are directly affected by re-

moval of the ore, while the beneficiaries in this case have only an equitable interest in the interest of the lessor, and suffer no loss of investment through depletion. The decision in *Merle-Smith* v. *Commissioner*, 42 F. (2d) 837 (C.C.A. 2d), certiorari denied, 282 U.S. 897, is contrary, we contend, to this Court's decision in *Anderson* v. *Wilson, supra*, since it disregarded the separate entity of trust and beneficiary in allowing deductions for depletion to the trust beneficiary.

ARGUMENT

I

THE ENTIRE AMOUNT OF ROYALTY PAYMENTS WAS INCOME IN THE CONSTITUTIONAL SENSE AND THE TAXPAYER IS NOT ENTITLED TO A DEDUCTION UNLESS THE STATUTE SPECIFICALLY AUTHORIZES IT

The income involved in this case consists of royalties paid to the trustees under the terms of a lease of mining property. These royalties were paid in full to the beneficiaries of the trust without any deduction except for costs of administration. (R. 80, 100.) The only question in the case is whether the beneficiaries of the trust are entitled to deduct from the payments received any sum on account of depletion of the mine.

It has been established by many decisions of this Court that the entire proceeds from the working of a mine are income in the constitutional sense and may be subjected to taxation without any allowance on account of depletion. In *Stanton* v. *Baltic Mining Co.*, 240 U.S. 103, the taxpayer contended that the income tax law of 1913 was unconstitutional

in its application to mining corporations because it made an inadequate allowance for depletion. But this Court rejected the taxpayer's contention. It held (pp. 113–114) that the argument

> rests upon the wholly fallacious assumption that looked at from the point of view of substance a tax on the product of a mine is necessarily in its essence and nature in every case a direct tax on property because of its ownership unless adequate allowance be made for the exhaustion of the ore body to result from working the mine. We say wholly fallacious assumption because independently of the effect of the operation of the Sixteenth Amendment it was settled in *Stratton's Independence* v. *Howbert*, 231 U.S. 399, that such a tax is not a tax upon property as such because of its ownership, but a true excise levied on the results of the business of carrying on mining operations (pp. 413 *et seq.*)

The same result was reached in several later cases, which, however, involved the Corporation Tax Act of August 5, 1909. *Von Baumbach* v. *Sargent Land Co.*, 242 U.S. 503; *Goldfield Consol. Mines Co.* v. *Scott*, 247 U.S. 126; *United States* v. *Biwabik Mining Co.*, 247 U.S. 116. So far as the constitutional question is concerned these cases are equally applicable to the question arising under an income tax act, as this Court pointed out in the quotation from *Stanton* v. *Baltic Mining Co.* set out above.

The rule of these cases has been recently reviewed by this Court in *Burnet* v. *Harmel*, 287 U.S. 103. This Court there said (pp. 107–108):

It was argued that since the net result of the mining operation is a conversion of capital investment as upon a sale, the money received by the corporate owner or lessor, being its capital in a changed form, could not rightly be deemed to be income. But that argument was rejected, both with respect to the proceeds of mining operations carried on by the corporate owner on its land, *Stratton's Independence* v. *Howbert, supra; Goldfield Consolidated Mines Co.* v. *Scott*, 247 U.S. 126; see *Stanton* v. *Baltic Mining Co.*, 240 U.S. 103, 114, and with respect to payments made by the lessee to the corporate lessor under the provisions of a mining lease. *Von Baumbach* v. *Sargent Land Co.*, 242 U.S. 503, 521, 522; *United States* v. *Biwabik Mining Co.*, 247 U.S. 116.

Although these cases arose under the Act of 1909,[3] before the enactment of the capital gains provision in the 1921 Act, they established, for purposes of defining "income" in a tax measured by it; that payments by lessees to lessors under mining leases were not a conversion of capital, as upon a sale of capital assets, but were income to the lessor, like payments of rent. And before the 1921 Act this Court had indicated (see *Eisner* v. *Macomber*, 252 U.S. 189, 207), what it later held, that "income," as used in the revenue acts taxing income, adopted since the Sixteenth Amendment, has the same meaning that it had in the Act of 1909. *Merchants Loan & Trust Co.* v. *Smietanka*, 255 U.S. 509, 519; see *Southern Pacific Co.* v. *Lowe*, 247 U.S. 330, 335.

[3] As has been pointed out above, *Stanton* v. *Baltic Mining Co.* arose under the Income Tax Act of 1913.

It therefore follows that the entire amount of the royalty received by the trustees in this case was income in the constitutional sense and that it lay within the power of Congress to tax it in full without the allowance to any one of a deduction on account of depletion.

The taxpayer is therefore claiming a deduction from an item which is admittedly subject to tax as gross income. It is well settled that a taxpayer is not entitled to a deduction as a matter of right and may have only such deductions as are specifically authorized by the statute. *Burnet* v. *Thompson Oil & Gas Co.*, 283 U.S. 301; *Von Baumbach* v. *Sargent*, 242 U.S. 503, *supra; Stanton* v. *Baltic Mining Co.*, 240 U.S. 103. We submit that there is no provision in the Revenue Acts of 1921, 1924 or 1926 which allows a deduction to a taxpayer on account of depletion of a mine leased by a trust of which he is a beneficiary.

II

UNDER THE REVENUE ACTS OF 1921, 1924 AND 1926, THE BENEFICIARY OF A TRUST IS NOT ENTITLED TO A DEDUCTION ON ACCOUNT OF THE DEPLETION OF A MINE LEASED BY THE TRUST

The section which relates to the taxability of trusts in the Revenue Acts of 1921, 1924 and 1926 is Section 219 (*infra*, pp. 27–30). This section is substantially the same in each of the three Acts, so far as the present question is concerned. It contains no express provision that a beneficiary of a trust shall be allowed a deduction on account of depletion of trust property; nor do we think that there is any room in Section 219

to imply an intention on the part of Congress that such a deduction should be allowed. As this Court pointed out in *Anderson* v. *Wilson*, 289 U.S. 20, 27, the question is not what a perfectly conceived statute should provide, but what the statute as we find it does provide.

By the terms of the trust in this case "all proceeds which shall come to the hands of the Trustees from said property or from any use which may be made thereof" were directed to be paid to the beneficiaries (R. 90). The trust is therefore one in which all of the current trust income is distributable to the beneficiaries. Section 219 (d) of the Revenue Act of 1921 provides that in such a case "the tax shall not be paid by the fiduciary", but—

> there shall be included in computing the net income of each beneficiary that part of the income of the estate or trust for its taxable year which, pursuant to the instrument or order governing the distribution, is distributable to such beneficiary, whether distributed or not * * *.

The provisions of Section 219 (b) (2) of the Revenue Acts of 1924 and 1926 (*infra*, p. 31) are substantially the same.

It should be noted that the statutes refer to "income", not "net income", and the beneficiary is required to report all income that is actually distributed to him under the trust. Where the trust instrument directs that "all proceeds" shall be distributed to the beneficiaries without providing for the establishment of a reserve for depletion, there is

consequently no authority in Section 219 for permitting the beneficiary to reduce the amount reported on account of depletion of property owned by the trust. The statute makes the beneficiary taxable on his distributive share, and on all of his distributive share. There is no provision that a beneficiary may take a deduction on account of depletion sustained by the trust.

If Congress had intended that the distributive share of a beneficiary should be reduced on account of depletion sustained by the trust, it seems reasonable to suppose that it would have said so. Express provision was made in the statute for other deductions to be made by the beneficiary,[4] and the fact that Congress did not provide for the deduction by a beneficiary on account of depletion sustained by the trust indicates its intention not to allow such a deduction. *Expressio unius est exclusio alterius.*

The claim of the beneficiary for a deduction on account of depletion is not supported, we submit, by Section 214 (a) (10) of the Revenue Act of 1921 (*infra*, pp. 26–27) and Section 214 (a) (9) of the Revenue Acts of 1924 and 1926 which provide for "a reason-

[4] Thus, in Section 219 (d) of the Revenue Act of 1921 and in Section 219 (f) of the Revenue Acts of 1924 and 1926 it is provided that a beneficiary of a trust may deduct from his distributive share for normal tax purposes his proportionate part of the amount received by the trust as dividends, and for all purposes his distributive share of tax exempt interest. And in Section 204 (c) of the Revenue Act of 1921, Section 206 (h) of the Revenue Act of 1924, and Section 206 (g) of the Revenue Act of 1926 it is provided that the benefit of the deduction for net losses shall be allowed to the beneficiaries of a trust.

able allowance for depletion and for depreciation of improvements." This provision appears in the same section of the statute as the provision allowing a deduction for "Losses sustained during the taxable year." Section 214 (a) (5) of the three Acts. The two deductions are obviously *in pari materia*. If Congress did not intend that a beneficiary of a trust should be allowed a deduction for "losses sustained" by the trust it would seem to follow that it did not intend to allow the beneficiary a deduction on account of depletion of the trust property.

In *Anderson* v. *Wilson*, 289 U.S. 20, this Court held that a beneficiary of a trust receiving distributions of the proceeds of sales of property of the trust as well as distributions of income therefrom was not entitled to a deduction for a loss sustained on such a sale. The Court there said (pp. 26–27):

> We hold that the trust, and not the taxpayer, has suffered the loss resulting from the sale of the Commercial Building, and it follows that where loss has not been suffered, there is none to be allowed. Whether the result would be the same if the beneficiaries had been the owner of future estates in remainder, we are not required to determine. Cf. *Francis* v. *Commissioner*, 15 B.T.A. 1332, 1340. Our ruling will be kept within the limits of the case before us. In so ruling we do not forget that the trust is an abstraction, and that the economic pinch is felt by men of flesh and blood. Even so, the law has seen fit to deal with this abstraction for income tax purposes as a separate existence, making its own return

under the hand of the fiduciary and claiming and receiving its own appropriate deductions. The Revenue Act of 1921 under which the tax in question was imposed defines the word "taxpayer" as including a trust or an estate. Revenue Act of 1921, c. 136, 42 Stat. 227, § 2 (9). The definition is pursued to its logical conclusion in a long series of decisions. *Baltzell* v. *Mitchell*, 3 F. (2d) 428; *Whitcomb* v. *Blair*, 58 App.D.C. 104; 25 F. (2d) 528; *Abell* v. *Tait*, 30 F. (2d) 54; *Busch* v. *Commissioner*, 50 F. (2d) 800, 801; *Roxburghe* v. *Burnet*, 61 App.D.C. 141; 58 F. (2d) 693; cf. *Merchants Loan & Trust Co.* v. *Smietanka*, 255 U.S. 509. These and other cases bear witness to the rule that an equitable life tenant may not receive a deduction for the loss of capital assets of the trust, though the result of such a loss is a reduction of his income. The argument will not hold that what was lost to this taxpayer was not the capital of the trust, but rather his own capital, withdrawn from his possession, but held for his account by the executors as custodians or bailiffs. His capital was in the proceeds, to the extent that they were distributed, and never in the land. We do not pause to consider whether a statute differently conceived and framed would yield results more consonant with fairness and reason. We take the statute as we find it.

In this case, as in the *Wilson* case, the beneficiaries of the trust might receive distributions of proceeds of the sale of property constituting the corpus of the

trust as well as distributions of income arising therefrom.[5] We submit that the same principles that prevented the allowance of a deduction for a capital loss to the beneficiary in the *Wilson* case prohibit the allowance of a deduction for depletion in this case.

The two deductions stand on precisely the same footing. The *Wilson* case arose under the Revenue Act of 1921. Section 219 of that Act and Section 219 of the Revenue Acts of 1924 and 1926, all three of which are involved in this case, provide that the income of a trust is to be taxed to the trust as a unit. The trust itself is the taxpayer (Section 2 of the three Acts; *Anderson* v. *Wilson*, *supra*), and is entitled to the same deductions that are allowable to an individual; for Section 219 (b) of the statutes provides that the net income of the trust (with exceptions not here material) shall be computed as that of an individual—that is, the gross income is determined as provided in Section 213, and the trust is entitled to the deductions specified in Section 214.

One of the deductions authorized under Section 214 of the three Acts is for losses in transactions entered into for profit—the deduction at issue in the *Wilson* case. Another deduction authorized under that section is a reasonable allowance for depletion, the

[5] The beneficiaries of this trust were entitled to receive all of the "proceeds" received by the trustees. This would include the right to the proceeds of the sale of the trust corpus, unless at the same time the holders of 51 percent of the beneficial interest in the trust required its termination, in which event the proceeds would go to the Pfister Land Company, the settlor.

deuction involved here. The trust and not the beneficiary is entitled to both deductions.

Section 214 makes no provision for a deduction on account of depletion by the beneficiaries of trusts. It does, however, expressly provide that the allowance for depletion shall be equitably apportioned between lessors and lessees. The fact that Congress provided for depletion in the case of lessees, and made no such provision in the case of trusts, indicates its intention that the deduction on account of depletion is to be taken in its entirety by the "taxpayer" who sustains the depletion, that is, the trust. That this construction was in accord with the understanding of Congress was indicated when, in the Revenue Act of 1928, c. 852, 45 Stat. 791, Congress included in Section 23 (b) a specific provision for the apportionment of depletion between beneficiaries and trustees. In enacting this provision Congress made it plain that it was making a change in the law. In House Report No. 1882, 70th Congress, 1st Session, the relevant portion of which is printed in full in the Appendix (*infra*, p. 34), it is stated (p. 11) that under the law in effect prior to the Revenue Act of 1928

> the deduction, in the case of property held in trust, is allowable only to the trustee.

It has been held in many cases that one taxpayer may not take a deduction properly allowable to another even though the "economic pinch" is ultimately felt by the former. *Anderson* v. *Wilson*, 289 U.S. 20, *supra; Dalton* v. *Bowers*, 287 U.S. 404; *Burnet* v. *Clark*, 287 U.S. 410; *Burnet* v. *Common-*

wealth Improvement Co., 287 U.S. 415; *Nixon* v. *Lucas*, 42 F. (2d) 833 (C.C.A. 2d); *Colston* v. *Burnet*, 59 F. (2d) 867 (App.D.C.), certiorari denied, 287 U.S. 640; *Falk Corp.* v. *Commissioner*, 60 F. (2d) 204 (C.C.A. 7th); *Busch* v. *Commissioner*, 50 F. (2d) 800 (C.C.A. 5th). As this Court pointed out in *Anderson* v. *Wilson*, *supra*, at p. 27, even though the trust is an "abstraction"—

> the law has seen fit to deal with this abstraction for income tax purposes as a separate existence, making its own return under the hand of the fiduciary and claiming and returning its own appropriate deductions.

In reaching its conclusion in *Anderson* v. *Wilson*, *supra*, this Court cited with approval the cases holding that an equitable life tenant may not take a deduction on account of depreciation of the trust property nor on account of a so-called "operating loss" of the trust. The cases cited were *Baltzell* v. *Mitchell*, 3 F. (2d) 428 (C.C.A. 1st), certiorari denied, 268 U.S. 690; *Whitcomb* v. *Blair*, 25 F. (2d) 528 (App. D.C.); *Abell* v. *Tait*, 30 F. (2d) 54 (C.C.A. 4th), certiorari denied, 279 U.S. 849; *Busch* v. *Commissioner*, 50 F. (2d) 800 (C.C.A. 5th); *Roxburghe* v. *Burnet*, 58 F. (2d) 693 (App. D.C.), certiorari denied, 286 U.S. 567. To these cases may be added *Roxburghe* v. *United States*, 64 C. Cls. 223, certiorari denied, 278 U.S. 598; *Codman* v. *Miles*, 28 F. (2d) 823 (C.C.A. 4th), certiorari denied, 278 U.S. 654; *Hubbell* v. *Burnet*, 46 F. (2d) 446 (C.C.A. 8th), certiorari denied, 283 U.S. 840; *Codman* v.

Commissioner, 50 F. (2d) 763 (C.C.A. 1st). See also *Commissioner* v. *Freuler*, 62 F. (2d) 733 (C.C.A. 9th) and *Burnet* v. *Whitcomb*, 65 F. (2d) 803 (App. D.C.) now pending before this Court on writs of certiorari, Nos. 129–131 and 139–150, October Term, 1933, which involve the additional question of the effect of a state court decision construing the will.

The respondents argue that Section 214 does not say who shall receive the benefit of the deduction for depletion but provides merely for a reasonable allowance. The same argument might as well be made of the "reasonable allowance" for depreciation which is authorized in the same sentence of the various Acts, but the courts in the cases cited above have recognized that the trust and not the beneficiary is the "taxpayer" who is entitled to the deduction for depreciation. Moreover, it is not specified in Section 214 (a) (5) who shall take the deduction for "losses sustained." Although the beneficiary in *Anderson* v. *Wilson* was the one who felt the "economic pinch," this Court held that the deduction could be taken only by the trust which held the title to the property. Similarly here, the mining property is owned by the trust and not by the beneficiaries and the trust alone is entitled to the deduction.

In *United States* v. *Ludey*, 274 U.S. 295, 303, this Court declared: "In essence, the deduction for depletion does not differ from the deduction for depreciation." We contend that there is no difference in the position of a beneficiary of a trust with regard to depreciation and depletion. In both cases if he is

entitled to receive income undiminished by depreciation or depletion, he is taxable upon that amount. He has never owned the property which is destroyed by depletion or depreciation, and if it does not outlast the trust, it is not his capital which is lost any more than the depreciation in *Weiss* v. *Wiener*, 279 U.S. 333, was a loss to the lessee who had not built the buildings.

The court below relied on *Lynch* v. *Alworth-Stephens Co.*, 267 U.S. 364, 370, where this Court held that the reasonable allowance for depletion provided by the Revenue Act of 1916 was allowable to a lessee engaged in mining, and stated that the allowance was to be given in case of a mine to everyone whose property right or interest therein has been depleted by the extraction and disposition of the product. But in that case the Court pointed out that the lessee's property interest in the mine consisted in its right to mine and remove the ore and reduce it to possession, and that this property interest (p. 370) "is lessened from year to year as the owner's property interest in the same mines is likewise lessened." But here the beneficiaries of the trust had no direct property interest in the mine. Their right was merely to receive "all proceeds", just as the right of the beneficiaries in *Anderson* v. *Wilson* was (p. 27) "in the proceeds, to the extent that they were distributed, and never in the land." The distinction between the present case and *Lynch* v. *Alworth-Stephens Co.*, *supra*, is emphasized by the decision in *Weiss* v. *Wiener*,

270 U.S. 333, where it was held that a lessee is not entitled to a deduction for depreciation on buildings erected by the lessor, since such buildings do not represent any investment on the part of the lessee. The distinction made between depletion and depreciation, so far as lessees are concerned, is not applicable to beneficiaries of a trust, because the beneficiary does not have any investment in the trust property, but merely a right to receive the "proceeds" after the trustee has dealt with the property in accordance with the terms of the trust.

The respondent also relies upon *Palmer* v. *Bender*, 287 U.S. 551. In that case it was held that a lessee of oil wells who leased them to another, stipulating for a royalty or bonus from the oil to be produced was entitled to an allowance for depletion, whether his conveyance was deemed a sublease or an assignment under the law of the State. But the Court did not hold that everyone receiving income which ultimately was derived from mineral property was entitled to a deduction for depletion. Its decision was based on the ground that the sublessor had an investment in the property and that he must look to the extraction of the oil for a return of his capital. The Court said (p. 557):

> The language of the statute is broad enough to provide, at least, for every case in which the taxpayer has acquired, by investment, any interest in the oil in place, and secures, by any form of legal relationship, income derived from the extraction of the oil, to which he must look for a return of his capital.

The position of the respondents in this case is wholly different from that of the sublessor in the *Palmer* case. The respondents as beneficiaries had no "investment" in the mineral property. The settlor of the trust interposed a separate entity between the beneficiaries and the ore deposits, and it is that separate entity which has an interest comparable to the lessee in the *Allworth Stephens* case and to that of the sublessor in the *Palmer* case. The position of the beneficiary is more akin to that of a stockholder in a corporation who is taxable on the full amount of the dividends which he receives, and may not deduct a loss which the corporation sustains. *Nixon* v. *Lucas*, 42 F. (2d) 833 (C.C.A. 2d); *Jamison* v. *Edwards*, 2 F. Supp. 302 (S.D.N.Y.); cf. *Dalton* v. *Bowers*, 287 U.S. 404. Conceding the correctness of the respondent's view that the conveyance of an interest in the income of a trust fund may be treated in equity as creating an interest in the fund (*Irwin* v. *Gavit*, 268 U.S. 161) or that such an interest is property (*Bryan* v. *Kennett*, 113 U.S. 179), a beneficiary's interest in the mineral property constituting the corpus of the trust is nevertheless only an equitable interest in the lessor's or lessee's interest in the mine, for the trust itself is the lessor or lessee. Hence the position of the beneficiary is substantially different from that of the lessor or lessee. The beneficiary has no invested capital to recover.

We contend, therefore, that the court below erred in not regarding *Anderson* v. *Wilson*, *supra*, as the controlling authority and also in failing to recognize

the substantial difference between the position of a lessee and a beneficiary of a trust. Because of that distinction neither *Lynch* v. *Alworth-Stephens Co.* nor *Palmer* v. *Bender* is persuasive here. The same errors, we contend, led to the similar decision in *Reynolds* v. *Cooper*, 64 F. (2d) 644 (C.C.A. 10th), now pending on writs of certiorari, Nos. 227-229, October Term, 1933.

Both courts likewise relied upon the decision in *Merle Smith* v. *Commissioner*, 42 F. (2d) 837 (C.C.A. 2d), certiorari denied, 282 U.S. 897. We contend that the *Merle Smith* case is contrary to the decision of this Court in *Anderson* v. *Wilson*, *supra*, since it disregarded the separate entity of trust and beneficiary in allowing deductions for depletion to the trust beneficiary. While that decision rested in part on a supposed distinction between depreciation and capital losses on the one hand, and depletion on the other, the controlling ground appears to have been the fact that in the principal trust involved the beneficiary would receive the corpus of the trust when she reached the age of 45, with power to dispose of it by will before, the trustee being prohibited from selling the property before that time.[8] The respondents argue that their position is very similar

[8] Since denial of the petition for a writ of certiorari in the *Merle-Smith* case, the Commissioner and the Board of Tax Appeals have both allowed deductions for depletion to the beneficiaries of trusts who have a remainder interest in the corpus. *Alphin* v. *Commissioner*, 21 B.T.A. 1101; *Kuhn* v. *Commissioner*, 24 B.T.A. 216; G.C.M. 9804, X-2 Cumulative Bulletin 353; G.C.M. 10273, XI-1 Cumulative Bulletin 169.

to that of the beneficiary in the *Merle-Smith* case for the reason that both the mining lease and the term of the trust extended far beyond the life of the mine, and thus that there will be nothing left of the ore reserves after the termination of the trust.

Upon this premise, the respondents contend that they had a property interest in the ore reserves. We submit that the right of the beneficiaries and the statutory allowance for depletion does not depend upon so variable a factor as the term of the particular trust. There seems to be no basis for saying that a beneficiary under a trust for a short term has no property interest in the ore reserved but that his interest is entirely different where the term of the trust extends beyond the life of the mine. The life of the mine depends upon the extent to which it is worked, and the argument that a beneficiary's right to a depletion allowance depends upon the operating program of those who are actually working the mine seems untenable. The respondent's interest as beneficiaries of the trust was merely a right to receive income. That interest would not change by the exhaustion of the mine, even though the income should stop. The grantor would still be the remainderman; the respondents' interest in the property does not depend upon the value which remains when the property is to be reconveyed.

The case of *Commissioner* v. *Molter*, 60 F. (2d) 498 (C.C.A. 10th), is similarly distinguishable. The court there held that where a husband and wife jointly invested their earnings in certain land, taking

title in the name of the husband, the wife was entitled to part of the depletion allowance with respect to oil wells discovered on the land. But the wife there could compel conveyance of title; she was in substance a part owner of the property. She had made an investment in the land itself and was accordingly entitled to a deduction on account of the depletion sustained with respect to that investment. The respondents here were neither owners, lessors nor lessees of the mine, and they had no investment in it and no interest in it beyond the right to receive income. They were entitled to receive and did receive distributions of trust income undiminished by deductions for depletion. We submit that they are not entitled to the deductions claimed.

CONCLUSION

The decision of the Circuit Court of Appeals is erroneous and should be reversed.

Respectfully submitted.

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NOVEMBER 1933.

APPENDIX

Revenue Act of 1921, c. 136, 42 Stat. 227, 239, 242, 246:

SEC. 214. (a) That in computing net income there shall be allowed as deductions:

* * * * *

(10) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: *Provided*, That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: *Provided further*, That in the case of mines, oil and gas wells, discovered by the taxpayer, on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, the depletion allowance shall be based upon the fair market value of the property at the date of the discovery, or within thirty days thereafter: *And Provided further*, That such depletion allowance based on discovery value shall not exceed the net income, computed without allowance for depletion, from the property upon which the discovery is made, except where such net income so computed is less than the depletion allowance based on cost or fair market value as of March 1, 1913; such reasonable allowance in all the above cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary.

In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee; * * *.

SEC. 215. (b) Amounts paid under the laws of any State, Territory, District of Columbia, possession of the United States, or foreign country as income to the holder of a life or terminable interest acquired by gift, bequest, or inheritance shall not be reduced or diminished by any deduction for shrinkage (by whatever name called) in the value of such interest due to the lapse of time, nor by any deduction allowed by this Act for the purpose of computing the net income of an estate or trust but not allowed under the laws of such State, Territory, District of Columbia, possession of the United States, or foreign country for the purpose of computing the income to which such holder is entitled.

SEC. 219. (a) That the tax imposed by sections 210 and 211 shall apply to the income of estates or of any kind of property held in trust, including

(1) Income received by estates of deceased persons during the period of administration or settlement of the estate;

(2) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests;

(3) Income held for future distribution under the terms of the will or trust; and

(4) Income which is to be distributed to the beneficiaries periodically, whether or not at regular intervals, and the income collected by a guardian of an infant to be held or distributed as the court may direct.

(b) The fiduciary shall be responsible for making the return of income for the estate or trust for which he acts. The net income of the estate or trust shall be computed in the same manner and on the same basis as pro-

vided in section 212, except that (in lieu of the deduction authorized by paragraph (11) of subdivision (a) of section 214) there shall also be allowed as a deduction, without limitation, any part of the gross income which, pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in paragraph (11) of subdivision (a) of section 214. In cases in which there is any income of the class described in paragraph (4) of subdivision (a) of this section the fiduciary shall include in the return a statement of the income of the estate or trust which, pursuant to the instrument or order governing the distribution, is distributable to to each beneficiary, whether or not distributed before the close of the taxable year for which the return is made.

(c) In cases under paragraphs (1), (2), or (3) of subdivision (a) or in any other case within subdivision (a) of this section except paragraph (4) thereof the tax shall be imposed upon the net income of the estate or trust and shall be paid by the fiduciary, except that in determining the net income of the estate of any deceased person during the period of administration or settlement there may be deducted the amount of any income properly paid or credited to any legatee, heir, or other beneficiary. In such cases the estate or trust shall, for the purpose of the normal tax, be allowed the same credits as are allowed to single persons under section 216.

(d) In cases under paragraph (4) of subdivision (a), and in the case of any income of an estate during the period of administration or settlement permitted by subdivision (c) to be deducted from the net income upon which tax is to be paid by the fiduciary, the tax shall not be paid by the fiduciary,

but there shall be included in computing the net income of each beneficiary that part of the income of the estate or trust for its taxable year which, pursuant to the instrument or order governing the distribution, is distributable to such beneficiary, whether distributed or not, or, if his taxable year is different from that of the estate or trust, then there shall be included in computing his net income his distributive share of the income of the estate or trust for its taxable year ending within the taxable year of the beneficiary. In such cases the beneficiary shall, for the purpose of the normal tax, be allowed as credits, in addition to the credits allowed to him under section 216, his proportionate share of such amounts specified in subdivisions (a) and (b) of section 216 as are received by the estate or trust.

(e) In the case of an estate or trust the income of which consists both of income of the class described in paragraph (4) of subdivision (a) of this section and other income, the net income of the estate or trust shall be computed and a return thereof made by the fiduciary in accordance with subdivision (b) and the tax shall be imposed, and shall be paid by the fiduciary in accordance with subdivision (c), except that there shall be allowed as an additional deduction in computing the net income of the estate or trust that part of its income of the class described in paragraph (4) of subdivision (a) which, pursuant to the instrument or order governing the distribution, is distributable during its taxable year to the beneficiaries. In cases under this subdivision there shall be included, as provided in subdivision (d) of this section, in computing the net income of each beneficiary, that part of the income of the estate or trust which, pursuant to the instrument or order governing the

distribution, is distributable during the taxable year to such beneficiary.

Revenue Act of 1924, c. 234, 43 Stat. 253, 269, 272, 275:

SEC. 214. (a) In computing net income there shall be allowed as deductions:

* * * * *

(9) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In the case of leases the deduction allowed by this paragraph shall be equitably apportioned between the lessor and lessee; * * *. (U.S.C., Title 26, Sec. 955.)

SEC. 215. (b) Amounts paid under the laws of any State, Territory, District of Columbia, possession of the United States, or foreign country as income to the holder of a life or terminable interest acquired by gift, bequest, or inheritance shall not be reduced or diminished by any deduction for shrinkage (by whatever name called) in the value of such interest due to the lapse of time, nor by any deduction allowed by this Act for the purpose of computing the net income of an estate or trust but not allowed under the laws of such State, Territory, District of Columbia, possession of the United States, or foreign country for the purpose of computing the income to which such holder is entitled. (U.S.C., Title 26, Sec. 956.)

SEC. 219. (a) The tax imposed by Parts I and II of this title shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) Except as otherwise provided in subdivisions (g) and (h), the tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary. The net income of the estate or trust shall be computed in the same manner and on the same basis as provided in section 212, except that—

* * * * *

(2) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under paragraph (3) in the same or any succeeding taxable year;

* * *

* * * * *

(c) For the purpose of the normal tax the estate or trust shall be allowed the same credit as is allowed to a single person under subdivision (c) of section 216, and, if no part of the income of the estate or trust is included in computing the net income of any legatee, heir, or beneficiary, then in addition the same credits as are allowed by subdivisions (a) and (b) of section 216.

(d) If any part of the income of an estate or trust is included in computing the net income of any legatee, heir, or beneficiary, such legatee, heir, or beneficiary, shall, for the purpose of the normal tax, be allowed as credits, in addition to the credits allowed to him under section 216, his proportionate share of such amounts specified in subdivisions (a) and (b) of section 216 as are, under this section, required to be included in computing his net income. Any remaining portion of such amounts specified in subdivisions (a) and (b) of section 216 shall, for the purpose of the normal tax, be allowed as credits to the estate or trust.

(e) If the taxable year of a beneficiary is different from that of the estate or trust, the amount which he is required, under paragraph (2) of subdivision (b) of this section, to include in computing his net income, shall be based upon the income of the estate or trust for its taxable year ending within his taxable year. (U.S.C., Title 26, Sec. 960.)

Revenue Act of 1926, c. 27, 44 Stat. 9, 26, 28, 32: Sections 214 (a) (9) (U.S.C. App., Title 26, Sec. 955), 215 (b) (U.S.C. App., Title 26, Sec. 956), and 219 (U.S.C. App., Title 26, Sec. 960), are identical with those above quoted.

Treasury Regulations 65:

ART. 294. *Life or terminable interests.*—Amounts paid to the holder of a life or termi-

nable interest acquired by gift, bequest, or inheritance shall not be subject to any deduction for shrinkage (whether called depreciation or any other name) in the value of such interest due to the lapse of time. In other words, the holder of such an interest so acquired may not set up the value of the expected future payments as corpus or principal and claim deductions for shrinkage or exhaustion thereof due to the passage of time.

No deduction shall be allowed in the case of a life or terminable interest acquired by gift, bequest, or inheritance, where the estate or trust is entitled to a deduction under the statute but there is no reduction of the income of the life or terminable interest. For example, an estate or a trust in a certain State sells securities at a loss; if, under the laws of that State, the beneficiary suffers no actual loss, then even though the estate or trust is permitted to deduct such loss in making its return, the beneficiary whose income has not been diminished thereby is not entitled to a deduction on account of such loss, but must include in his return the full amount distributed or distributable. See articles 341-347.

ART. 341. *Estates and trusts.*—In general, the income of a trust for the taxable year which is to be distributed to the beneficiaries must be returned by and will be taxed to the respective beneficiaries, but the income of a trust which is to be accumulated or held for future distribution, whether consisting of ordinary income or gain from the sale of assets included in the corpus of the trust, must be returned by and will be taxed to the trustee. The exception to this general rule is with respect to the income of a trust revocable by the grantor, and the income of a trust which may be distributed to the grantor or used to pay

the premiums upon policies of insurance on his life, which income, whether or not distributed, must be returned by and will be taxed to the grantor of the trust. (See article 347.)

See section 225 and articles 421 and 423 with reference to fiduciary returns, and article 294 with reference to deductions.

Treasury Regulations 69:

Articles 294 and 341 of Regulations 69 are substantially the same as those above quoted.

CONGRESSIONAL COMMITTEE REPORT

In the Conference Report on the Revenue Bill of 1928 (House Report No. 1882, 70th Congress, 1st Session) the following statement is made (pp. 11–12):

Amendment No. 30: Under existing law difficulty has been experienced in determining and allowing the deduction for depreciation in cases where property is held by one person for life with remainder to another person; and the deduction, in the case of property held in trust, is allowable only to the trustee. The Senate amendment provides that a life tenant, for the purpose of this deduction, shall be considered as the absolute owner; so that he will be entitled to the deduction during his life, and that thereafter the deduction, if any, will be allowed to the remainder man. In the case of property held in trust, the allowable deduction is to be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the will, deed, or other instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income which is allocable to the trustee and the beneficiaries, respectively. For example, if the trust instrument provides that the income of the trust computed without regard to depreciation shall be distributed to a named

beneficiary, such beneficiary will be entitled to the depreciation allowance to the exclusion of the trustee, while if the instrument provides that the trustee in determining the distributable income shall first make due allowance for keeping the trust corpus intact by retaining a reasonable amount of the current income for that purpose, the allowable deduction will be granted in full to the trustee. The bill contains similar provisions as to the deduction for depletion. The Senate amendment provides for an equitable apportionment of the deduction in these cases; and the House recedes.

U. S. GOVERNMENT PRINTING OFFICE: 1933